Subject 504

Interest Expense

Interest is an amount you pay for the use of borrowed money. To deduct interest you paid on a debt, you must be legally liable for the debt and have actually paid the interest. If you prepay interest, you must spread the interest over the tax years to which it applies. You may deduct in each year only the interest applicable to that year. Items you may deduct as interest on Form AR1000 and AR1000NR include: certain home mortgage interest, and investment interest.

Personal interest, such as car loans and credit cards, is not deductible.

In addition, you may deduct points you paid to borrow money to buy your home in they are charged only for the use of the money. Points are also called loan origination fees, maximum loan charges, or premium charges. However points charged for specific services such as getting a Veteran's Administration loan, preparation costs for a mortgage note, settlement fees, or notary fees are not interest and cannot be deducted.

Other items you cannot deduct as interest include: points if you are a seller, service charges, loan fees, credit investigation fees, interest related to tax exempt income, or to purchase or carry tax exempt securities.

Generally home mortgage debt is divided into two categories acquisition debt and home equity debt.

Acquisition deft is debt secured by your main or second home and used to buy, build, or substantially improve either home.

Home equity debt is debt secured by a main or second home but not used to buy, build, or improve either home. In other words, home equity debt can be deducted in addition to acquisition debt. If all of your mortgages fit into one or more of the following categories, you can deduct all of the interest on those mortgages and report on Form AR1000 or AR1000NR, page AR3.

1) Mortgages you took out on your main home on or before October 13, 1987 (acquisition debt). These mortgages also include line of credit mortgages you had on October 13, 1987 and mortgages you had on October 13 1987 that you refinanced after that date.

20 Mortgages you took out on your main home after October 13 1987 to buy, build, or improve your home (acquisition debt) but only if these mortgages plus any mortgages discussed in situation 1 totaled $1,000,000 or less throughout the current tax year. The limit is $500,000 if married filing separately.

3) Mortgages you took out after October 13, 1987 on your main home other than to buy, build, or improve your home (home equity debt) but only if these mortgages totaled $100,000 or less throughout the current tax year. The limit is $50,000 if married filing separately.

You cannot deduct this interest if you use the proceeds of the mortgage to receive tax free income..

A main home is the taxpayer’s principal residence. It can include a house, cooperative apartment, condominium, house trailer, or house boat. A second home can include a residence that is used part of the year or a residence that is rented out. If the residence is rented out, it is subject to the use requirements relating to vacation homes. However, a dwelling unit may qualify even if it is neither used nor rented.